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No. 208

In the Supreme Court of the United States

OCTOBER TERM, 1946

TRANSPARENT-WRAP MACHINE CORPORATION,
PETITIONER

v.

STOKES & SMITH COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

The United States files this brief *amicus curiae* because of the importance of the question presented to the administration of the patent laws. In a number of cases, the most recent of which is *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U. S. 661, this Court has struck down patent practices whereby a patentee has sought to "enlarge the monopoly of his patent by the expedient of attaching conditions to its use." In the instant case, as a condition to granting a license under its patent, the patentee has required the licensee to agree to convey to the patentee all patentable im-

provement of the licensed invention which the licensee invents or discovers. The Government believes that this practice, if upheld, would enlarge the patentee's monopoly beyond the scope of the licensed patent, and constitute a serious inroad upon the basic doctrine enunciated in the *Mercoid* and related cases. The reasons for this conclusion are set forth in this brief.

STATEMENT

Petitioner, Transparent-Wrap Machine Corporation, owned three patents issued in 1935 and 1936 (R. 243–267) on a machine for making envelopes (R. 22). Respondent, Stokes and Smith Co., manufactured, among other things, packaging machinery and filling devices (R. 27). In 1937, petitioner and respondent made an agreement (R 90), the pertinent provisions of which were: (1) Petitioner, in return for specified royalties, granted respondent an exclusive license to manufacture and sell under the three patents and any improvements thereon throughout the United States, Canada and Mexico for a period of ten years, with an option to renew for successive five year periods until the expiration of the three patents and any improvement patents. (2) Petitioner agreed to sell respondent its apparatus for making the machines and its existing stock of machines completed and in process and agreed to furnish know-how and sales information. (3) The agreement was subject to termination on certain conditions and if terminated within ten

years, petitioner agreed to buy back the business, including increments, at cost less depreciation at the rate of 20% per annum. (4) The parties agreed not to challenge the validity of the three patents. (5) Respondent apparently[1] agreed to license petitioner exclusively under certain improvement patents controlled by it in all territories not covered by the contract. (6) Under Article 12, respondent promised to submit improvement inventions, "suitable for use in connection" with the machine and "applicable to the making and closing of the package," made by it to petitioner with an option in the latter to apply for patents thereon; upon failure to exercise the option, respondent to have the right to apply for the patents itself, in which event petitioner would receive a non-exclusive license thereunder in all territories not covered by the contract; in either event, the patents would come under the contract. It is Article 12 that is in issue here.

In January, 1944, petitioner, having previously learned that respondent had applied for certain improvement patents, demanded assignment of the inventions to it pursuant to the agreement (R. 105). Respondent did not accede and in April, 1944, petitioner notified the latter of its election to terminate the contract as of May 10, 1944 (R. 108). On May 19, 1944, respondent instituted this action

[1] Judge Hand referred to this provision as "obscure." 156 F. 2d, at 199 (R. 314).

to determine the validity of the assignment provisions (R. 2). Petitioner counter-claimed, demanding assignment of fourteen patents (R. 6), three of which were later withdrawn upon the trial (R. 47, 51, 55). The District Court, dismissing the complaint, found the contract valid and breached, held that petitioner had a right to terminate, and directed respondent to assign to petitioner the eleven patents in question and to disclose to it all improvements in which it had any interest (R. 295). The Court below reversed. Judge Hand, speaking for the majority, held that the promise to assign the improvement patents was illegal and unenforceable. The case was remanded to the District Court for determination of the question of restitution, on the premise that respondent's repudiation of his promise to assign, although proper, excused petitioner from further performance (R. 312). A petition for rehearing was denied (R. 330).

ARGUMENT

THE REQUIREMENT BY THE PATENTEE, AS A CONDITION TO GRANTING A LICENSE UNDER ITS PATENT, THAT THE LICENSEE CONVEY TO IT ALL PATENTABLE IMPROVEMENTS OF THE LICENSED INVENTION WHICH LICENSEE INVENTS OR DISCOVERS, ENLARGES THE PATENTEE'S MONOPOLY BEYOND THE SCOPE OF ITS LICENSED PATENT AND IS ILLEGAL AND UNENFORCEABLE

This Court has many times held that a patentee "by attaching a condition to his license * * * may not enlarge his monopoly and thus acquire some other which the statute and the patent together did not give." *Ethyl Gasoline Corp.* v.

United States, 309 U. S. 436, 456; *Morgan Envelope Co.* v. *Albany Paper Co.,* 152 U. S. 425; *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.,* 243 U. S. 502; *Carbice Corp.* v. *American Patents Development Corp.,* 283 U. S. 27; *Leitch Mfg. Co.* v. *Barber Co.,* 302 U. S. 458; *Morton Salt Co.* v. *G. S. Suppiger Co.,* 314 U. S. 488; *B. B. Chemical Co.* v. *Ellis,* 314 U. S. 495; *Mercoid Corp.* v. *Mid-Continent Inv. Co.,* 320 U. S. 661; *I. B. M. Corp.* v. *United States,* 298 U. S. 131. Since this Court has found such practices contrary to public policy, it has been unnecessary to consider the further question whether the limitation also violates the antitrust laws. *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.,* 243 U. S. 502, 521; *Morton Salt Co.* v. *G. S. Suppiger Co.,* 314 U. S. 488, 494. See also *Standard Oil Co.* v. *United States,* 283 U. S. 163, 169, ftn. 2.

While this doctrine has been most frequently applied to cases in which the patentee has attempted to use his patent to obtain competitive advantage in the sale of unpatented materials, it is our view that it is equally applicable to the condition imposed upon the licensee in the instant case.[2] Here, as in the "tying" cases, the peti-

[2] This case involves an attempt by the petitioner to enforce the condition of the license in a direct action against its licensee. Hence, this Court need determine only whether such a provision is or is not enforceable. It need not decide here whether the petitioner may be barred from suing for infringement of its patents. See *Leitch Mfg. Co.* v. *Barber Co.,* 302 U. S. 458; *Morton Salt Co.* v. *G. S. Suppiger Co.,* 314 U. S. 488; *B. B. Chemical Co.* v. *Ellis,* 314 U. S. 495.

tioner is attempting to obtain an extension of its monopoly, to wit, the assignment to it of patents covering improvements upon or relating to the inventions covered by its patents. This it accomplishes by refusing to license its own patents unless such monopoly rights are given to it by the licensee. While the type of extended monopoly which petitioner acquires is somewhat different from that which was sought in the "tying" cases, it is our view that the extended monopoly involved here is fully as objectionable, if not more so, from the standpoint of the public interest and a vigorous competitive system as that which results from a "tying" agreement.

A. *The requirement that improvement patents be assigned to the licensor results in a concentration of patents in the licensor's hands which broadens the scope of its monopoly and renders its monopolistic position more unassailable.*—At the time petitioner granted the license here involved, it owned three patents covering packaging machines. If the conditions of the license were held enforceable, petitioner would now become the owner of eleven additional patents, issued upon inventions resulting from efforts of others. How many additional patents petitioner might obtain, assuming the agreement remained in force, would depend upon the licensee's future inventive activity. Inasmuch as the agreement was to run until the last improvement patent had expired, subject

to the licensee's decision not to renew at the end of any given 5 year period (a decision which the licensee would be increasingly hesitant to make as the number of improvement patents obtained by it and assigned to the patentee, increased), the agreement could continue for an indefinite period of time with a consequent continuous accretion to the patent holdings of the licensor.

This Court has commented upon the concentration of patents in the hands of a single owner and has pointed out the undesirability of such concentration. *Hartford-Empire Co.* v. *United States*, 323 U. S. 386, 407. See also Vaughan, *Economics of Our Patent System* (1925), p. 224; Hamilton, *Patents and Free Enterprise* (TNEC Monograph No. 31, 1941), pp. 46–7, 59. Such concentration is objectionable for three reasons.

First, it broadens the scope of the patentee's original monopoly in that the assigned patents cover inventions which are useable independent of the original patents and to that extent gives the petitioner a power of exclusion which it did not originally possess. In the instant case, the licensee manufactured machinery which did not fall within the licensor's three original patents. The licensee subsequently made improvements which presumably, in the absence of any evidence in the record to the contrary, could have been used with such machinery. Yet the effect of the assignment of these patents, coupled with a termination of the license agreement, would preclude any

further use by licensee of the improvements which it had invented, at least in connection with the patented machines and any machines competing with them (R. 100).

Second, the mere existence of a large number of patents in the hands of a single patentee, even though many of them may be narrow or invalid, may well discourage individuals who would otherwise be disposed to challenge his patent position. It is one thing to challenge one or two patents which stand in the way of free use of the given technology. It is quite another thing to be compelled to meet and defeat a large number of patents before one is free to use the latest developments in the field.

Third, while a single patent concededly creates a monopoly within the limited scope of its claims, there is still room for competition between different patents, just as there is room for competition between varying grades and types of unpatented materials. Situations frequently arise in which one patented invention may be used instead of another. If the patents are held by different owners, a person desiring to use one of the inventions is free to deal with the party who is prepared to make him the best offer. Where ownership is concentrated in the hands of a single owner, no such opportunity arises.

B. *The requirement that improvement patents be assigned to the licensor extends its patent monopoly beyond the life of the patents granted upon*

its own inventions.—Concentration of patents resulting from the assignment requirement not only broadens the scope of the patentee's monopoly and strengthens his monopolistic position, but also extends it in point of time. Petitioner's three patents which were the subject of the license agreement will all have expired by 1953 (R. 243–267). The eleven improvement patents which respondent would be required to assign to petitioner do not expire until 1956–1959 (R. 115–226). Enforcement of the agreement would consequently enable petitioner, *by virtue of his ownership of the earlier expiring patents,* to continue to levy a toll upon respondent for several years after the patents covering its own contribution have expired. If the agreement were terminated by respondent's election or as a result of its default, respondent would thereafter be precluded from using the improvements at all. Nor, in the situation as contemplated when this contract was made, would this unfortunate result be limited to six years. The agreement was so framed that, but for a serious controversy such as has arisen, respondent would be unlikely to terminate, because of the serious impairment of its own interests. Assuming respondent continued to make improvements which would then be assigned to petitioner, the period during which petitioner might continue to maintain its monopoly could extend indefinitely.

Beyond this, it may well be that petitioner's monopoly based upon its own contribution will terminate before 1953. Should the petitioner's patents be declared invalid, as many patents are, its monopoly would then cease, but for the monopoly rights received from the assigned patents. Nor is it realistic to argue that after the expiration of its three original patents, everyone, including licensee, is free to make the *unimproved* machines covered by them. As a practical matter, at least in competitive fields, inability to make use of improvements may be tantamount to exclusion.

C. *The requirement that improvement patents be assigned to the licensor discourages invention by the licensee, contrary to the purpose of the patent system.*—Contractual arrangements whereby the operator of a business is deprived of the benefits of his collateral research is bound to discourage invention and research on his part, particularly if, as here, the patents resulting therefrom may be asserted against him at a later date. While it is true that respondent here did make a number of inventions, there is nothing to show that it would have made them had it been convinced that they must be turned over to petitioner. Nor can it be assumed that respondent would not have made more inventions had it been sure that it could retain their ultimate benefit. Certainly, under the facts of this case, a realization by respondent that recapture of the business or termi-

nation of the agreement by petitioner was probable or imminent, would completely discourage further inventive effort on his part.

The situation is quite unlike that which arises in employee contracts whereby an employee is hired to invent and is required to assign his inventions to his employer. In such cases the employee is paid to do research. Since the employer bears the costs of the research activities, he should receive the benefits. This is not the case here. In employment cases, the encouragement to invent on the part of the employee comes from the payment of a salary in return for his efforts and the realization that his salary will cease if he fails to produce. In contrast, the present situation involves the conduct of a business in which the potential inventor has no obligation to conduct research, but if he does conduct it he must do so at his own expense and the benefits thereof accrue to the other party to the agreement. Such a situation holds no inducement to undertake research. In this sense the agreement is somewhat comparable to that in which an employee is required to turn over to his employer inventions made by him after his employment contract has terminated and independent of his activities while employed. In such cases, the courts have held the agreements contrary to the public interest and unenforceable. *Guth* v. *Minnesota Mining & Mfg. Co.*, 72 F. 2d 385 (C. C. A. 7), certiorari denied, 294 U. S. 711,

and cases cited; *New Jersey Zinc Co.* v. *Singmaster*, 71 F. 2d 277 (C. C. A. 2), certiorari denied, 293 U. S. 591; *Standard Plunger Elevator Co.* v. *Stokes*, 212 Fed. 893 (C. C. A. 2).[3]

D. *If improvement inventions are made, the assignment requirement, in practical effect, compels the licensee eventually to pay for the use of expired patents, contrary to the Marcalus doctrine.*—If the respondent operates on the assumption that the license will not be terminated, it may undertake research and thereby develop a number of patentable inventions; in other words, carry on the sort of activity which the patent system was designed to encourage. If respondent does this, however, it will find itself in a position where withdrawal from the agreement without serious detriment to its own interests becomes increasingly difficult. The greater respondent's inventive contribution, the more it stands to lose if the agreement is terminated. Nevertheless, unless respondent does terminate the agreement, it must continue to contribute the stipulated license royalty (R. 92, 93) for the privilege of using inventions which were its own product and developed at its own expense, merely because at the outset petitioner licensed it to use the three original patents which may have long since expired.

[3] *Thibodeau* v. *Hildreth*, 124 Fed. 892 (C. C. A. 1). But compare *Goodyear Tire & Rubber Co.* v. *Miller*, 22 F. 2d 353 (C. C. A. 9); *Wege* v. *Safe-Cabinet Co.*, 249 Fed. 696 (C. C. A. 6); see *Appleton* v. *Bacon & North*, 2 Black (U. S.) 699; *Dalzell* v. *Dueber Mfg. Co.*, 149 U. S. 315.

In practical effect, petitioner, because it licensed respondent under the three original patents, imposes upon licensee a promise to pay for the privilege of using these inventions and improvements thereon, long after the original patents have expired. In *Scott Paper Co.* v. *Marcalus Co.*, 326 U. S. 249, this Court held that the patent laws declare a policy that inventions covered by expired patents become public property and that members of the public shall not be required to pay a toll for the privilege of using them. It would seem that this doctrine is fully as applicable to those situations, such as this one, where an attempt is made to achieve this result by indirection as it is to those situations where the requirement is baldly stated.

E. *The licensor's legitimate interests can be adequately protected without requiring that the licensee assign the improvement patents.*—Notwithstanding the undesirable effects of requiring the assignment of improvement patents, it has been urged that such a requirement is necessary for the protection of petitioner's interests in the event that the business reverts to it. It is sufficient here to point out that the assignment requirement goes far beyond anything necessary to protect the licensor's interests. As long as the contract remains in force, the licensor has no interests that require protection by calling for the assignment of improvement patents. If the agreement is terminated and the licensor takes back the going business of the licensee, it may be conceded that

licensor should have the right to use the improvements developed by licensee, inasmuch as some of the machinery developed and built by licensee presumably incorporates those improvements. This could be accomplished by an agreement by the licensee to grant to the licensor, in case of reverter, a non-exclusive, unrestricted license under his improvement patents. Petitioner is not content with this, however. It demands not merely a right to use the improvements, but the right to exclude all others, including respondent who invented them, from using them without its consent. This demand is predicated upon the fact that more than nine years ago petitioner licensed respondent under three patents owned by it which will expire in another seven years. It is our contention that petitioner's demand goes beyond what is necessary for its protection and, under the doctrines enunciated by this Court, is unenforceable when imposed as a condition to the grant of a license under said patents.

F. *Authorities relied upon by petitioner do not require a conclusion contrary to that urged herein.*—Petitioner urges that *Hartford-Empire Co.* v. *United States,* 323 U. S. 386, supports its position that the restriction in the license agreement requiring the assignment of improvements is legal. (Pet. 11.) We do not so interpret that decision. In that case this Court had before it a provision in the District Court decree which enjoined appellants

from requiring that all improvements covering the licensed machinery become its property. This Court modified the decree by limiting the injunction to improvements "applicable to feeders, formers, stackers and lehrs and processes and methods applicable thereto" (p. 424). Thus, this Court did clearly hold the provision illegal and unenforceable in so far as it was invoked in these designated fields. These were the fields in which this Court found that violation of the antitrust laws occurred (pp. 406–7) and, consequently, the fields which it deemed appropriate for injunctive action. The Government agreed to these limitations (p. 423). Under these circumstances, the failure of this Court to extend the injunction to other fields of activity not found to be involved in antitrust violation, cannot be interpreted as an approval of this type of licensing provision.

The case of *Allbright-Nell Co.* v. *Stanley Hiller Co.*, 72 F. 2d 392 (C. C. A. 7), decided in 1934, requires little comment. At that time this Court had already rendered its decision in the *Carbice* and several earlier cases heretofore cited, but the full significance and meaning of the doctrine if was enunciating, as set forth in subsequent cases such as the *Leitch, Ethyl, Morton Salt* and *Mercoid* cases, was not fully appreciated. We submit that

the decision below accurately reflects and faithfully follows this doctrine, whereas the 1934 *Allbright-Nell* decision does not.

Respectfully submitted.

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